OCTOBER 2009

Members of Congress in October made the final moves before votes on health care reform by both the House and Senate, setting up major partisan battles over the issue in November. The Senate Finance Committee approved its long-awaited reform proposal, one that rejected a government-run insurance plan in favor of non-profit cooperatives, but it appears that the bill that will be voted on by the full Senate will contain a public option, nevertheless. The House bill likewise has a public option, virtually guaranteeing that, unless changes are made – and that is not unlikely – no Republican will vote for health care reform on the House or Senate floor. Lawmakers also advanced several components of a financial regulation overhaul package that is a response to the nation's recent financial crisis.

ISSUES AND EVENTS

House, Senate Close to Votes on Health Care Reform

House Democrats on Oct. 29 unveiled the health care reform bill that will be put to a vote by the full chamber, an $894 billion plan that, among other things, would create a government-run insurance option.

"This is about the character of our country," House Speaker Nancy Pelosi, D-Calif., said. "The bill is fiscally sound, will not add one dime to the deficit as it expands coverage, implements key insurance reforms and promotes prevention and wellness across the health system."

In addition to establishing a public option, the "Affordable Health Care for America Act" (H.R. 3962), a merger of bills passed by three House committees, would require individuals to have health insurance, provide subsidies for the purchase of insurance (contingent on income levels), create exchanges to connect consumers with insurers, expand eligibility for Medicaid, prohibit insurance denials based on pre-existing conditions and impose an income tax surcharge on individuals with incomes of more than $500,000 and couples with incomes of more than $1 million.

Pelosi made a concession to moderates by having payment rates in the public option subject to negotiations between providers and the secretary of health and human services. This disappointed many liberal Democrats who want payments based on Medicare rates, but it appears to have been successful in winning over some members of the party who might otherwise have opposed the bill.

"I'm going to vote for it because it pays providers fairly," Rep. Earl Pomeroy, D-N.D., said.

In the Senate, meanwhile, Majority Leader Harry Reid and others have completed the merger of reform bills passed by the Finance Committee and the Health, Education, Labor and Pensions (HELP) Committee and are waiting for an estimate of the bill's cost from the Congressional Budget Office. The HELP Committee bill was very similar to the House bill (though it did not have the income tax surcharge), while the Finance Committee legislation was the most moderate of all of the major proposals and included non-profit cooperatives rather than a government-run plan.

Details regarding the combined bill have not been made public, but it reportedly contains a public option that offers states the opportunity to opt out. As a result, all Republicans are sure to oppose the bill, and it may not receive the unanimous support of Democrats that will be needed to get the 60 votes required for passage since some moderates are also wary of the government-run plan as it is designed in the bill.

This is likely just the starting point for debate by the full Senate, though, and some observers have suggested that Reid wants to put this version before the chamber to demonstrate to liberal members of his party that they don't have the votes for passage and make them more willing to accept a modified proposal. A revised version could include a public option with state opt-ins – rather than opt-outs – as favored by Sen. Ben Nelson, a moderate Democrat from Nebraska, or a "trigger mechanism" suggested by moderate Republican Sen. Olympia Snowe of Maine that would implement a government-run plan only in states in which certain conditions regarding cost and coverage were not met.

"The solution is competition and many multiple choices," Sen. Mary Landrieu, D-La., said after leaving a meeting of Senate moderates on Thursday. "Some of it could be for profit; some of it could be not-for-profit, and maybe as this debate goes forward, we end up with something along the lines of what Senator Snowe has been arguing for as a backstop."

NCHC Offers Plan to Save $1 Trillion in Health Care Costs

The National Coalition on Health Care (NCHC) on Oct. 22 released a report that contains a set of health care reforms that it says would save more than $1 trillion over the next 10 years.

The coalition asserted in the report that "waste" in the health care system over the next decade could be as much as 10 times the amount of savings identified in the report, "which estimates that 30 to 40 percent of all direct health care outlays are the result of poor quality care, consisting primarily of overuse, underuse, and waste."

"The Coalition questions why – when we have a health care system that is projected to waste an estimated $10 trillion over the next ten years – are we raising taxes to pay for reform rather than focusing on better utilization of the money already in the system," the report states. "The sources of America's health care crisis are intrinsically linked; so too must be the steps we take to address them."

Included in the report are proposals to:

- Improve health information technology.
- Expand comparative effectiveness research (including cost as a factor but not as the focus).

- Focus on prevention and wellness programs.
- Allow generic biopharmaceuticals to enter the market.
- Invest in oversight programs to cut fraud, waste and abuse.
- Reform the medical malpractice system in a way that includes “clear linkages between tort reform and care quality/patient safety strategies.”
- Provide alternatives to the fee-for-service model that would “offer stronger incentives to align payment to quality, reward providers and hospitals that are doing what’s right for patients, and making health care more efficient and less costly.”

CalPERS is an active member of NCHC – CalPERS Board Member George Diehr serves on the coalition board – and has worked with the group to promote the report’s proposals on Capitol Hill.

Senate Panel Approves Bill Banning Prescription Drug ‘Exclusion Payments’

The Senate Judiciary Committee on Oct. 15 approved legislation that would ban “pay-not-to-play” deals between brand-name pharmaceutical makers and generic manufacturers.

The 1984 Hatch-Waxman Act included provisions that encourage generic companies to challenge drug patents that may be invalid. Some of these legal challenges are settled with a promise by the brand-name company to pay the generic manufacturer and an agreement by the generic company not to produce its own version of the drug whose patent it had challenged for a certain time. The brand-name company thus maintains market exclusivity and the generic company gets more money than it could have earned by selling its product. (Other generic companies are legally blocked from manufacturing their own version of the drug during this process.)

Critics of these “exclusion payments” say they are anti-consumer and anti-competitive and keep drug prices artificially high by preventing generics from entering the market sooner. The "Preserve Access to Affordable Generics Act" (S. 369) from Sen. Herb Kohl, D-Wisc., would ban such agreements.

“Passage of this bill will end an egregious practice that denies consumers the benefits of generic drug competition,” Kohl said. “At this time when we are all trying to find ways to save costs in our health care system, this bill will go a long way by saving us billions of dollars a year.”

Kohl proposed the same bill in the previous session of Congress with CalPERS support, but the legislation never made it out of committee.

Financial Regulation Reform Bills Advance

The House Financial Services Committee in late October approved bills that would reform credit rating agencies and regulate hedge funds as part of a larger effort to overhaul the nation’s financial regulations in the wake of the recession and market downturn.

The committee on Oct. 28 voted 49-14 in favor of the "Accountability and Transparency in Rating Agencies Act" from Rep. Paul Kanjorski, D-Penn. The bill would, among other things, clarify the ability of individuals to sue credit rating agencies, require one-third of the directors on agency boards to be independent and impose new disclosure requirements and rules regarding conflicts of interest.

“As gatekeepers to our markets, credit rating agencies must be held to higher standards,” Kanjorski said. “We need to incentivize them to do their jobs correctly and effectively, and there must be repercussions if they fall short. This bill will take such steps. I look forward to moving it through the legislative process.”

Critics have charged that credit rating agencies are partly responsible for the nation’s financial crisis because they failed to sound the alarm about the mortgage-backed securities that contributed to the recession.

CalPERS Senior Investment Officer Eric Baggesen appeared at a Sept. 30 House Oversight and Government Reform Committee hearing on credit rating agencies, telling lawmakers that “CalPERS considers comprehensive reform of the credit ratings industry to be sorely needed in order to ensure transparency and accountability across the capital markets.”

A day before the vote on the credit rating agencies bill, the Financial Services Committee approved the "Private Fund Investment Advisers Registration Act," also sponsored by Kanjorski, by a 67-1 vote. The legislation would require private advisers to hedge funds and other private pools of capital to register and would impose new rules and disclosure requirements on the advisers.

The panel also released a draft bill intended to address “systemic risk” issues late in October. The Financial Stability Improvement Act would create the Financial Services Oversight Council to monitor financial entities and activities that could threaten the stability of the nation’s entire financial system and would establish procedures for the “orderly wind-down of failing firms” to replace government bailouts of companies considered “too big to fail.” The bill received the blessing of Treasury Secretary Timothy Geithner at a committee hearing on Oct. 28.

“It represents a comprehensive, coordinated answer to the moral hazard problem posed by our largest, most interconnected financial institutions,” Geithner said of the legislation. “It produces strong, accountable supervision of all our major financial firms and imposes costs not on the taxpayer but with the risk-takers, where they belong.”

The House Energy and Commerce Committee, meanwhile, approved legislation on Oct. 29 that would create the Consumer Financial Protection Agency to oversee mortgages, student loans, credit cards and other consumer financial products. The version passed by the panel, though, differs from the one approved the previous week by the Financial Services Committee in that it would have the agency run by a five-member commission rather than a single person. Financial Services Committee Chairman Barney Frank, D-Mass., the bill’s sponsor, criticized the change, saying it would “weaken the capacity of the agency to provide consumer protection.”

“The director will have the benefit of an oversight board of bank regulators and consumer groups as well as a diverse advisory board to provide broader input,” Frank said. “But that input should be provided without diminishing the capacity to act promptly and effectively, which is best done by a single regulator.”

Executive Pay to be Slashed for Biggest Bailout Beneficiaries

The official reviewing executive pay at the seven companies that received the largest federal bailouts has ruled that cash compensation for the top executives at those firms should be cut by an average of more than 90 percent.

The tens of billions of dollars in "exceptional" financial assistance that was granted to these companies through the government's Troubled Asset Relief Program (TARP) was provided with certain strings, including federal control over the compensation of the firm's top executives. Special Master for TARP Executive Compensation Kenneth Feinberg on Oct. 22 released his findings following a study of executive compensation at the seven companies – AIG, Citigroup, Bank of America, Chrysler, GM, GMAC and Chrysler Financial. Under his rulings for the top 25 executives at those companies:

- Cash bonuses are to be replaced with company stock that must be held for the long-term.
- Annual salaries are to be limited to $500,000 for nearly all of the executives, cutting average cash compensation by more than 90 percent and reducing total compensation by more than half.
- Salaries are to be paid in company stock, all of which must be held until at least 2011 (unless a company pays back all of the TARP money it received).
- Incentive compensation is to be contingent on performance and TARP repayment and is to be paid with long-term restricted stock.
- Increases in "golden parachute" payments are prohibited, supplemental executive compensation plans are frozen and payments for "personal expenses" are generally capped at $25,000.

"I believe we struck that proper balance between public dissatisfaction with principled decisions on compensation that will keep people at their chairs, attract talent and let the company prosper in order to pay the taxpayer," Feinberg said. "That's the real goal."

Critics of the limits say that they will allow other companies to hire away the top talent at those seven firms. Kenneth Langone, the co-founder of Home Depot and a former New York Stock Exchange board member, for example, said the pay cuts are "sheer stupidity."

"The taxpayers have an enormous financial risk in these companies, and very simply stated, I want the best person," Langone said. "If I needed neurosurgery, I would want the finest doctor I could get, no matter what I had to pay for it."

The rulings are to apply through the end of 2009. (Compensation already received this year will not be affected.) Feinberg is expected to issue a new set of rules in early 2010.

On the same day that Feinberg announced his decisions, the Federal Reserve said that it would review the compensation policies at 28 banks. In addition, it proposed that the pay of traders and certain other employees be, to some extent, inversely proportional to the amount of risk they take in doing their jobs.

House Passes Bill Allowing Public Pension Divestment from Iran

The House of Representatives on Oct. 14 passed by a 414-6 vote a bill that would allow state and local governments to divest their pension funds of certain companies doing business in Iran.

The "Iran Sanctions Enabling Act of 2009" (H.R. 1327) from Financial Services Committee Chairman Barney Frank, D-Mass., would allow divestments of companies that have at least $20 million invested in Iran's energy sector; provide Iran with tankers for oil or liquefied natural gas or with products for oil or liquefied natural gas pipelines; or extend at least $20 million in credit to be used in Iran's energy sector.

"This bill makes it very clear that Americans who are deeply concerned about the prospect of an Iranian nuclear power and other aspects of Iranian governance are able to act on those concerns," Frank said. "In particular, it says that no one in this country ought to involuntarily have his or her money put to the support of the Iranian economy."

Frank sponsored a similar bill in 2007 that passed the House but never got out of committee in the Senate. A companion bill in the Senate – that also never made it out of committee – was sponsored by then-Illinois Sen. Barack Obama.

This year's bill awaits consideration by the Senate.

RELATED NATIONAL AND INDUSTRY NEWS

CalPERS Responds to *Washington Post* Pensions Article

CalPERS in October prepared a fact sheet to respond to pessimistic predictions about public pensions in a recent story in *The Washington Post*.

The financial crisis, the *Post* reported on Oct. 11, has led to doubts about "whether these public systems will be able to keep their promises to future generations of retirees."

"The upheaval on Wall Street has deluged public pension systems with losses that government officials and consultants increasingly say are insurmountable unless pension managers fundamentally rethink how they pay out benefits or make money or both," the story continued, citing forecasts that funding ratios could dip below 50 percent within a decade. "After losing about $1 trillion in the markets, state and local governments are facing a devil's choice: Either slash retirement benefits or pursue high-return investments that come with high risk."

The lengthy article also hinted that public pensions had a role in the financial crisis, reporting that, "Before the crisis, many public pension funds had experimented with risky trading techniques or committed more of their money to hedge funds and other nontraditional firms, which in turn invested some of it in complex mortgage securities. When these melted down, pension funds got burned." It then noted that, "Now, facing an even bigger funding gap, some systems are investing in the same securities, betting that a rebound in their value will generate huge returns."

In its response, CalPERS stated that the story "falls short on some important facts about public pension funds' ability to withstand market downturns and the merits of our long-term investment strategy and horizon." It noted that it has averaged annual returns of 7.75 percent over the past

20 years, that it has earned 10 percent or more in 16 of the last 20 and that its investments have returned $40 billion in just the last few months.

While many of the story's specific examples focused on funds in Maryland and Virginia, it did mention that CalPERS has lost $634 million from "securities lending" as of last spring yet "remains committed to the practice," has invested $2 billion in "toxic bank [real estate] assets" even though "the crisis showed how unreliable these investments can be" and recently invested $463 million in shopping centers, an investment that the story characterized as a "gamble."

CalPERS defended its investment practices, stating that it is a prudent investor with a well-diversified portfolio and that it has "fine-tuned our asset allocation to keep pace with market developments and give our staff flexibility to harness opportunities." It addressed the shopping center investment issue specifically, noting that it "sold this same portfolio at the height of the market in 2005 for $2.7 billion and purchased it back valued at $1.7 billion. Because we are a long-term investor, we have the benefit of holding the portfolio of properties again over time benefiting from a recovery."

Even while presenting the doomsday scenarios, though, the story indicated that things might not be so bad, after all.

"Public systems still have enough to meet their current obligations," it said. "If governments take no action, retirees could keep drawing full benefits for the foreseeable future even under the most pessimistic projections."

Ex-SEC Chairman Calls 'Pay-to-Play' at Public Pensions a 'National Disgrace'

A presidentially-appointed panel should be created to investigate the "national disgrace" of "pay-to-play" arrangements at public pensions, former SEC Chairman Arthur Levitt said in mid-October.

"It's pervasive," Levitt said. "It's in pension funds all around America, and people are being badly hurt by this."

Levitt's comments came after CalPERS disclosed that the placement agent firm of Alfred Villalobos, who served on the CalPERS Board from 1993 to 1995, has been paid $50 million by money managers in recent years for marketing investments to the pension fund, investments that, *The Wall Street Journal* reported, "have been among CalPERS's worst performers." CalPERS has called for a special review of fees paid to placement agent firms. Villalobos has asserted that he, employees of his company and CalPERS Board members all "acted appropriately."

The Securities and Exchange Commission (SEC) is considering a package of anti-pay-to-play measures that would prohibit investment advisers from:

- providing advisory services to a pension fund for two years after making political contributions to officials who can influence the selection of advisers for that fund;
- soliciting contributions for elected officials who can influence the selection of advisers for a fund with which they are seeking to do business;
- paying a third party to solicit a government client on their behalf;

- directing funds to officials through a third party in an attempt to avoid the above restrictions.

The National Association of State Retirement Administrators (NASRA) and eight other groups involved in public employee retirements recently warned in comments on the proposals that the new rules "could be far more deleterious to the public plan or government than to the investment adviser it is intended to discipline."

The groups cautioned that the restrictions could force "abrupt terminations" of trusted investment advisers, which could have negative impacts on the continuity of investments, leave pension funds without adequate counsel on investment strategy, raise contract-related liability issues and "undermine the fiduciary duty" of plan trustees.

The SEC considered a similar set of rules during Levitt's tenure in 1999, but did not adopt them.

"We had a lot of pressure [from lawmakers] against it, threats to take us to court," Levitt said. "When you talk about campaign contributions, Congress gets very sensitive. They feel that's one step away from their own activities."

Associations Argue Against Foreign Bank Reporting Requirements for Public Plans

Three national public pension groups on Oct. 6 asked the IRS to exclude state and local retirement plans from certain financial reporting requirements.

The Bank Secrecy Act requires that a report of Foreign Bank and Financial Account (known as FBAR) be filed, according to the IRS, by "any United States person who has a financial interest in or signature authority, or other authority over any financial account in a foreign country, if the aggregate value of these accounts exceeds $10,000 at any time during the calendar year."

The letter from the National Association of State Retirement Administrators, the National Council on Teacher Retirement and the National Conference of State Legislatures noted that since public pensions are tax-exempt entities, "there is no incentive for plan trustees to hide assets or investments from the U.S. government."

"Furthermore, these plans are creations of state law, municipal ordinance and often state constitutions," the letter continued. "Given this design, public plans receive a high degree of oversight and public scrutiny. Therefore, it is our view that a requirement of FBAR reporting and recordkeeping by public pension plans will not further the aims of the statute and will instead create an unproductive and unnecessary administrative burden for plans. Further, it will often be the case that the information public plans would report, is already being reported by U.S.-domiciled investment entities in their own FBAR forms."

While the IRS states that "'person' includes individuals and all forms of business entities, trusts, and estates," the tri-association letter, as well as attached letters from the State of Wisconsin Investment Board and attorneys with Ice Miller, LLP, argued that, for a governmental entity to be subject to the law, the U.S. secretary of the treasury must explicitly declare that they are. Since no declaration has ever been made, the letter concluded, the IRS should provide guidance clearly indicating that public pensions are not covered by the reporting requirements.

CALIFORNIA CONGRESSIONAL DELEGATION NEWS

Climate Change Bill Mark-Up Scheduled; GOP to Boycott

The Democratic chair of a Senate committee said in late October that the panel would begin work on a climate change bill on Nov. 3, but Republican members of the committee announced that they would boycott the session.

Senate Environment and Public Works Chair Barbara Boxer, D-Calif., a co-sponsor of the bill, responded to the GOP announcement by saying she would proceed as scheduled.

The “Clean Energy Jobs and American Power Act” from Boxer and Sen. John Kerry, D-Mass., would require 2020 carbon emissions to be 20 percent below the 2005 level and 2050 emissions to be 80 percent below the 2005 level. In addition, it would establish a market for the trading of emissions allowances, provide funding for clean coal technology and promote the use of natural gas, nuclear energy and renewable energy sources.

Republicans charge that the bill would impose a de facto “energy tax” that would slow economic growth, and GOP members of the committee said they would not participate in the Nov. 3 mark-up because they do not yet have a full economic analysis of the legislation from the Environmental Protection Agency.

The House narrowly passed a similar bill from Rep. Henry Waxman, D-Calif., in June.

In September, CalPERS and 180 other investors signed on to a statement from the International Investor Forum on Climate Change that urged world leaders to reduce carbon emissions by between 50 and 85 percent by 2050.